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SUBJECT: RUSSIA - THE POLITICS OF INFLATION

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- [1](#)B. (B) MOSCOW 5007
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Summary

[1](#)1. (SBU) In a campaign that many here characterize as a referendum on Putin and his policies, few expected that the problem of inflation would emerge to distract the public's attention from the broader economic stabilization that has succored the president's popularity. Putin's team, which was apparently unable to keep this from becoming an election issue, has been compelled to react with "stabilization measures" and its own information campaign to convince voters that it is able to resolve the issue. Recent polling data suggest that these measures have been only partly successful and political pundits here are linking an October drop in United Russia's popularity with the increase in prices. The central leadership, however, appears divided on the best way to handle the problem. Premier Zubkov and others are advocating populist "Soviet" solutions of greater government intervention, while cooler heads of the economic leadership like Deputy Premier and Finance Minister Aleksey Kudrin promote market-based solutions. END SUMMARY.

The Issue

[1](#)2. (SBU) The prospect of high inflation in September overshadowed the economic highlights of the first half of 2007 -- record private net capital inflows, record initial public offerings (IPOs), and stronger than expected GDP growth -- and undermined Kremlin hopes for another "successful" year. Official statistics for September put the year-end goal of 8 percent inflation out of reach and threatened to exceed the 2006 result of 9 percent. Consumer prices on a host of core food products skyrocketed in September according to the Russian Statistics Agency. (reftel b.) The price of vegetable oil rose 13.5 percent and the cost of dairy products by 7.5 percent during the month, elevating inflation's status in the public discourse from one of perennial aggravation to that of a political issue in the upcoming elections.

[1](#)3. (SBU) Press reports link the decline in United Russia's popularity, which fell from 56 percent to 50 percent, according to a survey by the government-owned polling company VTsIOM for the second half of October, to the increase in prices and people's anxiety about inflation. Food security issues are still relevant to many Russians, for whom memories of Soviet scarcity are not all that distant. A decade or so beyond since the difficult Gorbachev and Yeltsin eras, during which shelves were emptied of food supplies or when goods were priced beyond the reach of average citizens, questions

about rising prices on food continue to have special resonance, particularly among those on fixed incomes. In 2005, pensioners took to the streets in a number of towns across Russia to protest administrative reforms that sought to monetize social security benefits, which many then saw as a threat to their personal economic security.

¶4. (SBU) Survey data from the Levada Center polling company in October showed that 82 percent of respondents viewed inflation as "very high," up from 52 percent in June. Half of the respondents could not answer why inflation had jumped, but the "monopolization and greed of traders and producers" and "government inactivity" topped the list of explanations (with 12 and 8 percent of respondents, respectively). Many Russians want their government to take a more active role: in a separate Levada poll, 64 percent of the respondents said that they would more likely vote for a party that was for "strengthening the role of the government in the economy and in regulating market reforms."

Field Day for Leftist Parties

¶5. (SBU) Russia's "opposition" parties seized upon the issue as a chink in the armor of the seemingly invincible United Russia, with left and right blaming the administration for allowing inflation to "threaten" society again. While there is little risk rising food prices have the ability to change the political landscape substantially, the issue may well have significance on the electoral margins. To the extent that they are successful in turning concern about prices into dissatisfaction with "Plan Putin," parties like the Communist Party of the Russian Federation (KPRF) or even "For a Just Russia" (SR) may hope that they can leverage the issue into more votes.

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¶6. (SBU) Chairman of the Federation Council and SR leader Sergey Mironov has eschewed direct criticism of administration policies, reflecting his party's support for Putin, but has poured vitriol on "greedy" middlemen and called for more government regulation of food prices. In a press conference in mid-October, Mironov impugned "the scandalous practices of re-sellers" for artificially driving up prices and he advocated making the government the primary purchaser for food supplies to stop the "speculation" in prices. Mironov has advocated re-nationalization of the wholesale and retail food industry. On October 30, he further called for compensating families for the increased costs of food.

¶7. (SBU) Public concern about rising food prices has provided grist for the Communist Party, which has gleefully used the media attention to the issue to blame the Putin administration and promote its "socialist" economic agenda. According to the KPRF's Center for Research of Political Culture of Russia, in October there were more than 20 demonstrations across the country protesting the increase in prices on food, many of which were organized by the party. The largest protests -- involving between 1,000 and 1,500 citizens -- took place in Krasnodar Kray, Novosibirsk, Astrakhan, and Moscow city. The rise in prices for basic goods hits hardest those on a fixed income or pensions; Communist campaigning on this issue helps to mobilize the party's core constituency. Party chairman Gennadiy Zyuganov and others in the KPRF leadership have leveraged concerns about rising prices into a rallying cry against liberal economic policies, including moving to market prices for electricity, gas, housing, and railway transportation. Indeed, the party's platform calls for the restoration of collective state farms.

¶8. (SBU) Leftist candidates also have made much of Russian imports of food from abroad, seeing this as evidence of weakness. In a speech in Rostov oblast, given in late

October, Zyuganov denounced Putin's policies undermining the country's "food security," claiming that 46 percent of the country's food resources came from abroad. The mercurial leader of the Liberal Democratic Party of Russia, Vladimir Zhirinovskiy has long harangued the Putin administration for allowing Russia to become an importer of foodstuffs. In a press conference on November 8, he called it "shameful" that Russia -- a historical exporter of grain -- no longer could guarantee its food security.

The Kremlin Reacts

¶9. (SBU) The Kremlin, which was apparently unable to use its considerable administrative heft to keep inflation from becoming an election issue, has reacted with "stabilization measures" and an "information campaign." During a heated discussion with Cabinet ministers in early October, Putin reportedly criticized Agriculture Minister Gordeev sharply for not taking sufficient action to shore up Russia's food supply. Gordeev subsequently teamed up with Federal Tax Service Director Tatyana Shevtsova and Federal Antimonopoly Service Director Igor Artemev to visit Moscow-area grocers to assess the retailers' supply arrangements and methods for pricing bread, milk, and cooking oils. The group's findings informed Premier Zubkov's October 15 admonition to regional governors and municipal leaders to "look into pricing policies on socially significant food items and stop price growth on them."

¶10. (SBU) Comments from various officials, however, suggest that Putin's team is divided on the issue. Although Premier Zubkov and others favor more populist and "Soviet" solutions of greater government intervention, Deputy Prime Minister and Finance Minister Aleksey Kudrin and other economic ministers have encouraged a more market-friendly approach. Kudrin was reported to have urged Zubkov and Gordeev against imposing price controls. Media coverage of the issue quoted Kudrin as arguing that "we have a market economy. This does not correspond to the principles of a market economy."

¶11. (SBU) Already, experts here see the measures that the Kremlin has instituted as distorting the food market and predict they will fail to achieve any of the inflation-reducing goals it has proclaimed. Ministry of Agriculture foreign relations chief Andrey Vershinin told Embassy that price freezes on 8 product categories is pointless and will have no impact on constraining inflation. Signatories are also under no obligation to sell products on the list. An attendee of the meeting at MinAg at which 30 signatories agreed to freeze prices "voluntarily" for 8

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product groups said Russian officials characterized the agreement as "an opportunity for firms to behave in a socially responsible way" while acknowledging the agreement is unenforceable. To date, no list of products for which prices are frozen has been published, and even a MinAg department director was unable to produce a copy. The list is reputed to include specific types of foods, such as milk containing less than 1 percent fat, meaning that higher-fat content milk will be sold at unregulated prices.

¶12. (SBU) The government measures could have some negative unintended consequences. According to local economists, the GOR's administration's inflation-fighting ironically may lead to greater inflation. Renaissance Capital Chief Economist Katya Malofeeva said the GOR's anti-inflation campaign would have the effect of raising the shelf prices of goods not targeted by the price agreement. As transportation and other overhead costs continue to inch upward, retailers will continue to pass along part of these costs to customers. "The winners, meaning products with unregulated prices, will have to pay for the losers, meaning products with frozen prices and eroding margins. All of which means higher prices," according to Malofeeva.

¶12. (SBU) COMMENT: The inflation issue demonstrates the Kremlin's limited ability to control the political dialogue in the country and could help to derail plans for a United Russia constitutional majority in the Duma. Worries about rising prices have cut deeply into the party's jump in the polls that followed Putin's announcement that he would lead the party list, indicating a trend away from YR. Moreover, the continued prevalence of the issue, heightened by campaigning by YR opponents, serves to strengthen public concern and, because expectations of inflation tend to create greater inflation, to deepen the problem. It remains to be seen if the KPRF or other leftist parties are able to convert public nervousness about prices into measurable electoral gains, but the Kremlin appears concerned about this happenstance.

¶13. (SBU) Moreover, it appears that the President's team sees the emergence of inflation as an indictment of Putin's legacy. According to Goldman Sachs Executive Director for Economic Research Rory MacFarquhar, "Putin already thought of the missed target as a failure." Moreover, memories of the 2005 protests against the monetization of benefits likely haunt Putin's team, which remains neuralgic about a spontaneous "orange revolution" in Russia and seeks to ameliorate any social discontent that leads to spontaneous demonstrations. There are concerns that the government will feel compelled to implement further short-term solutions to throttle inflation if only to demonstrate that the government is doing "something." While administrative controls may constrain inflation for a time, inevitably they will result in reduced supply, leading to either shortages or higher inflation in the long run when the government relaxes control, likely after the December Duma elections. END COMMENT.
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